City of Mesa
Deferred Compensation Committee
MEETING MINUTES
Monday, February 3, 2014, 11:30am
Mesa City Plaza, Suite 130
Personnel Conference Room 2

Members Present:
Chuck Odom (Chair)
Mike Kennington (Co-Chair)
Don Miller
Frank Hoglund
Kimberly Call
Mary Dellai
Vicki Eden

Members Absent:
Derek Witting
Michele Long
Michael Claspell

Innovest:
Gordon Tewell
Jerry Huggins

Great West:
Scott Taylor
Lisa Tilley

Other(s):
Bill Taebel
Nikki Rosales

Meeting called to order at 11:30am by Mike Kennington

1. **Approval of the November 4, 2013 minutes**
   Frank motioned to approve the minutes
   Vicki seconded the motion
   None opposed

2. **Innovest Quarterly Update**

   The Markets
   The chart provided showed the 4th quarter and year to date returns for 2013. S&P 500 up 32%, which was the best year since 1997. Small cap stocks up more than 38%. International stocks up more than 22% for the year, even with the difficulties that Europe had. The one weak spot was the Barclay US Aggregate Bond with a negative 2%. In general, most signs seem positive.

   Headwinds
   The U.S. Federal Reserve began tapering its quantitative easing program. Economic growth is still fragile outside of the U.S. The political climate across the globe has been challenging. Trade balances are starting to falter on the emerging market side and they're not exporting as much as they have in the past. Soft wage growth is a challenge in the U.S. Consumer spending is good right now, but not sure how long it will last, due to the slow wage growth. Unemployment rates are dropping, but are mostly due to people exiting the job market, rather than job creation.

Tailwinds

Consumer spending trends continued, as retail sales remained strong. Vehicle sales are the best they've been, since 2007. This shows consumers' willingness to take on extended dept. Defined contribution accounts are healthier. Home prices have rebounded across the country. Over the last 18 months, there has been better growth in lending. Small business and real estate have been drivers of growth for new loans, though there has been a slight scale back in real estate lending.

Quarterly Market Summary

In equity markets, S&P was at 10.5%, but emerging markets were the soft spot at 1.9%. Fixed incomes were low or negative for the quarter, with high yield bonds as the only highlight. For the year, all fixed incomes sectors were negative, with the exception of high yield bonds at 7.4%. In other parts of the market, REITs remained negative, whereas Hedge Funds were up just slightly. Commodity funds were just negative, mostly driven down by falling gold prices. In the U.S. market, small-cap growth companies were the best place to be for the year, up over 43%. Technology stocks, consumer discretionary stocks and industrial stocks were the three strong sectors for the quarter. In the international markets, all sectors finished the year over 20%, other than emerging markets, which was negative 2.3%. Europe and Japan had solid performances for the year, but Australia lagged. Overall, annual performance was significant.

Periodic Table of Returns 2004-2013

The table shows the last 10 years of performance over a variety of asset classes. The one thing to note is that performance over time appears to be random and, generally, if you're at the top, you're going to fall to the bottom. For example, REITs led the way the last 3 years, but had a tough year in 2013. Diversified portfolios are encouraged, because they tend to be less volatile, as shown in the chart, and you end up with a solid return.

Annual Fee Review

The plan assets, as of 6/30/13, were $136,600,109. The current assets, as of 12/31/13, not provided in the report, are over $150 million. The administrative and record keeping costs of the plan are still far below our peers.

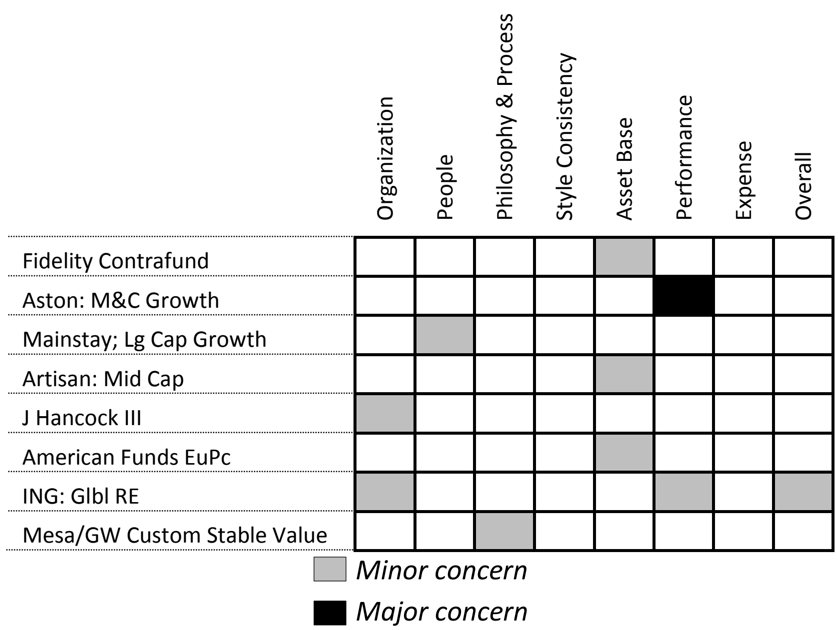
Asset Allocation

No significant changes this quarter. The Stable Value Fund declined from $41.6 million to $41.2 million, but a decline that small could be distributions, especially at year-end. There was good growth this quarter with total plan assets at $8.4 million, which is about 5.61%.

Table of Returns

Absolute performance within the year was great, but relative performance was mixed. Most managers did well against the benchmark, with the exception of a couple. Aston Montag & Caldwell Growth fund ranked close to its peers for the quarter, but its relative performance compared to the 1-year index ranked it in the bottom 4% of large cap growth managers. In strong equity markets they tend to underperform, but they protect on the downside, and we selected them for the way they manage money. Allianz NFJ Dividend Value fund performed close to its peers for the quarter, but the 1-year numbers ranked it in the bottom 13% of managers. The manager of this fund buys dividend paying stocks, which tend to suffer in this type of market, when interest rates are rising. Their absolute performance is still exceptional and their 3 year numbers show that they're still doing a good job. International funds had strong absolute gains and superior performance, relative to their peers and the benchmarks. Global Equity was in line with its peers for the quarter and outperformed peers for the 1-year period, but slightly underperformed the benchmark. Fixed Income trailed for the year and ended with negative returns, though it did outperform the benchmark for the quarter. High Yield had great performance and ranked just below the benchmark for the year. Stable Value performed very well relative to the benchmark for the quarter and the year. ING Global Real Estate has been on the watch list and underperformed the benchmark for the year, but relative to its peers, it did better than the median. The 3 and 5 year performance for ING is not great either. All target date funds outperformed their benchmarks for the quarter. All target date funds above 2015 outperformed their benchmarks for the year. All the custom model portfolios outperformed their benchmarks for the quarter, as well as the year.

<u>Manager Scorecard</u>



- Fidelity Contrafund-removed minor concern for Style Consistency
- Vanguard Mid and Small Caps-changed the index they were managing to, so the minor concern on Philosophy & Process were removed from both funds
- Aston Montag & Caldwell-minor concern on Performance changed to major concern
- Next quarter, PIMCO will change Organization to a minor concern, due to the CEO's unexpected departure in mid-March

New Watch List

Watch List Criteria	MainStay Large Cap	Aston Montag & Caldwell	Artisan Mid Cap	J Hancock III	Artisan International Inv	ING Global Real Estate
NUMBER OF QUARTERS ON THE WATCH LIST	*3*	*2*	*1*	*1*	*1*	*3*
Changes in Ownership Structure or Material Litigation						
Investment Management Team Changes						
Significant Increase/Decrease in Assets Under Management						
Investment Style Stable/Consistent and Adherence to Investment Guidelines						
Performance In-Line with Expectations						

All shaded boxes indicate a FAIL in that criteria

- This new format indicates how many quarters an item has been on the watch list.
- Significant Increase or Decrease in Assets will be triggered if there is a difference greater than 10% in either direction
- MainStay Large Cap had a manager departure earlier in the year.

3. Updated Investment Policy Statement

Innovest provided a redlined version of the Investment Policy Statement, showing the recent revisions made. Most changes were clean-up items, changing several plurals (plans to plan). The major change to the IPS dealt with incorporating the language for the new watch list and removing the old criteria. The old watch list focused around performance measures. There were seven categories on the old list, of which four related to performance. The performance categories were combined into one on the new list. A clean copy of the revised IPS circulated to the committee members for signature, prior to this meeting. The document still requires Great West review and signature. Innovest will send a final copy to the city, once all signatures have been obtained.

4. Great West Quarterly Update

Updated Documents

Scott provided samples of updated documents, related to the plan. The enrollment kit was updated, as well as the plan features and highlights. He also provided the fliers for the Roth 457 option, the online deferral changes and a copy of the newsletter that went into the 4th quarter statements.

Asset Allocation Comparison 2013 vs. 2012

A comparison of participant accounts by age group from 2012 to 2013 was provided. Most age groups from last year to this year have more people investing in premixed portfolios, which is typically a good thing. One problem with premixed portfolios is unintentional misuse, where people have a stock option in the premixed fund, such as mid-cap stock, and then put an additional percentage in an individual fund of the same type of stock. That is generally not a good idea, because it can throw off your overall asset allocation. Over the one year period, there was a decrease in the number of participants that were using both options. The 50-59 and 60+ age groups had a slightly higher usage of both premixed options and other options. Speculation is that they could have a number of people doing a premixed option and a stable value fund. Most age groups had a decrease of participants that were using just the other investment options. In the 29 and under group, the number of people using target date funds went down, whereas the number using just other options went up. Some of the new employees may be used to having managed account service in the private sector, so they may feel more comfortable going that route.

4TH Quarter Update for 2013

Online contribution changes and Roth contributions are now working. Standard withdrawals for retirees and other terminated employees no longer require city signature, as long as GW has a termination date for the employee, which is being sent to them on a bi-weekly basis. Also, approval of incoming rollovers, without city signature, is now operating, as long as the correct paperwork is filled out.

Plan assets were at $156,762,809 for the quarter. Participants continue to contribute, but a lot of the increase is due to market appreciation. The number of participant accounts is at 2,749 for the 4th quarter, which is down slightly, but still higher than the 1st quarter. The overall net cash flow for the year is consistent with that of 2012. Payroll contributions were at $2,046,053, and incoming rollovers brought in an additional $551,520. Scott did mention that there were a few hundred in Roth contributions as well, but it was not included on the report.

There were 55 new loans issued, 31 full withdrawals, 3 unforeseeable emergencies and 12 outgoing rollovers.

NAGDCA Comparison

The 2013 NAGDCA study included 89 governmental 457 plans. Mesa has an average plan participation rate of 65.7%, whereas the average in the NAGDCA study is 23%. Mesa's average participation account balance is at $55,489, which is higher than the NAGDCA average, but mostly due to market appreciation. Mesa's average participant annual contribution is at $3,694, which is lower than the NAGDCA average, so this is an area to work on.

Investment Advisory Services Usage

The plan offers 3 levels of investment services: Guidance, Advice and Managed Accounts.
There are 7 participants utilizing the advice service and the use of managed accounts increased to 364. There is still no record of the guidance account service being utilized.

Local Education

Scott held four seminars on the online contribution changes and the Roth option. He had 9 individual meetings with staff, held 14 group meeting and presented at 2 new employee orientations.

On the Horizon

Working on outsourcing death benefit claim processing to GW and implementing automatic loan processing, which would eliminate city approval.

5. GW Strategic Partnership Plan 2014

This is the annual review to look at how the plan functioned last year and determine what to do this year. GW continues to have strong ratings and growth, servicing over 7,000 employers across the U.S.

There is not much to improve on, in regards to the plan design, since it offers most available features. Some options not included in the plan are Auto Enrollment and Auto Increase. The Roth 457 option and Online Deferral Process were implemented on November 4, 2013. Online Enrollment was discussed last year, but the city would have to provide GW with information of non-participating eligible employees, which may be problematic.

Boston College did a study to find out how prepared state and local workers are for retirement. The study suggests that participants should have a minimum 80% income replacement to maintain their living standards, though it may be necessary to have 100%, as many have outstanding mortgages. The results showed 30% of workers had 72% income replacement, whereas 70% of workers had 48-57% income replacement, so none of them met the 80% minimum. GW plans to reveal a Retirement Readiness Report Card, identifying the number of city employees ready for retirement.

The city's participation rate looks good against the benchmark and increased by 1% from 2012 to 2013, meeting the annual goal. Suggested tools to increase participation are auto enrollment, contacting long-term employees that are not participating to remind them of the plan option and providing EZ enrollment forms. Auto enrollment would have the most impact, because studies show participants typically do not opt out, but this city is not currently looking at this option. The average annual contribution was $3,694 and the average account balance was $55,489. There needs to be focus on increasing annual contributions, because $55k is far below the amount that people will need for retirement. Auto Increase would be a great tool, although participants are able to set increases on their own, using the Retirement Income Control Panel on the website. A mailing or newsletter may need to highlight this feature again. It is apparent participants are trying to create diversified portfolios. Broken down in three categories, 13.2% of participants are in the Help-Me-Do-It category, which includes those using target date funds and the 6 advice accounts. The Do-It-For-Me category includes those utilizing managed accounts and is at 13.3%. The Do-It-Myself category is at 73.5%. That percentage indicates many people are still doing allocations on their own and should be revisiting their accounts and monitoring their investments over time. Annual distribution totals for the plan decreased in 2013. Participants should continue to be reminded that it is not necessary to take your money out, once you retire.

Action Items and Goals:

- Scott's goal is to have 185 group meetings and 450 individual meeting in 2014, with focus on individual analysis.
- Increase participation rate by 1% in 2014
- Increase savings rate, by no specific percentage, since it decrease last year
- Increase usage of target date funds and managed accounts, by no specific percentage

6. Next Meeting will take place on May 5, 2014

7. Meeting Adjourned at 1:15pm